

## § 1.357-1

## 26 CFR Ch. I (4-1-03 Edition)

transferred in connection with the performance of services (and representing reasonable compensation) within the meaning of section 351(g)(2)(C)(i)(II). Thus, the P preferred stock received by A is QPS.

(f) *Effective dates.* This section applies to transactions occurring on or after October 2, 2000.

[T.D. 8904, 65 FR 58651, Oct. 2, 2000]

### § 1.357-1 Assumption of liability.

(a) *General rule.* Section 357(a) does not affect the rule that liabilities assumed are to be taken into account for the purpose of computing the amount of gain or loss realized under section 1001 upon an exchange. Section 357(a) provides, subject to the exceptions and limitations specified in section 357 (b) and (c), that—

(1) Liabilities assumed are not to be treated as “other property or money” for the purpose of determining the amount of realized gain which is to be recognized under section 351, 361, 371, or 374, if the transactions would, but for the receipt of “other property or money” have been exchanges of the type described in any one of such sections; and

(2) If the only type of consideration received by the transferor in addition to that permitted to be received by section 351, 361, 371, or 374, consists of an assumption of liabilities, the transaction, if otherwise qualified, will be deemed to be within the provisions of section 351, 361, 371, or 374.

(b) *Application of general rule.* The application of paragraph (a) of this section may be illustrated by the following example:

*Example.* A, an individual, transfers to a controlled corporation property with an adjusted basis of \$10,000 in exchange for stock of the corporation with a fair market value of \$8,000, \$3,000 cash, and the assumption by the corporation of indebtedness of A amounting to \$4,000. A's gain is \$5,000, computed as follows:

Stock received, fair market value .....	\$8,000
Cash received .....	3,000
Liability assumed by transferee .....	4,000
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Total consideration received .....	15,000
Less: Adjusted basis of property transferred .....	10,000
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Gain realized .....	5,000

Assuming that the exchange falls within section 351 as a transaction in which the gain to be recognized is limited to “other property

or money” received, the gain recognized to A will be limited to the \$3,000 cash received, since, under the general rule of section 357(a), the assumption of the \$4,000 liability does not constitute “other property.”

(c) *Tax avoidance purpose.* The benefits of section 357(a) do not extend to any exchange involving an assumption of liabilities where it appears that the principal purpose of the taxpayer with respect to such assumption was to avoid Federal income tax on the exchange, or, if not such purpose, was not a bona fide business purpose. In such cases, the total amount of liabilities assumed or acquired pursuant to such exchange (and not merely a particular liability with respect to which the tax avoidance purpose existed) shall, for the purpose of determining the amount of gain to be recognized upon the exchange in which the liabilities are assumed or acquired, be treated as money received by the taxpayer upon the exchange. Thus, if in the example set forth in paragraph (b) of this section, the principal purpose of the assumption of the \$4,000 liability was to avoid tax on the exchange, or was not a bona fide business purpose, then the amount of gain recognized would be \$5,000. In any suit or proceeding where the burden is on the taxpayer to prove that an assumption of liabilities is not to be treated as “other property or money” under section 357, which is the case if the Commissioner determines that the taxpayer's purpose with respect thereto was a purpose to avoid Federal income tax on the exchange or was not a bona fide business purpose, and the taxpayer contests such determination by litigation, the taxpayer must sustain such burden by the clear preponderance of the evidence. Thus, the taxpayer must prove his case by such a clear preponderance of all the evidence that the absence of a purpose to avoid Federal income tax on the exchange, or the presence of a bona fide business purpose, is unmistakable.

[T.D. 6500, 25 FR 11607, Nov. 26, 1960, as amended by T.D. 6528, 26 FR 399, Jan. 19, 1961]

### § 1.357-2 Liabilities in excess of basis.

(a) Section 357(c) provides in general that in an exchange to which section